

Morningstar DBRS Changes Trend on the City of Madrid to Positive, Confirms at "A"

SUB-SOVEREIGN GOVERNMENTS

DBRS Ratings GmbH (Morningstar DBRS) confirmed City of Madrid's (Madrid) Long-Term Issuer Rating at "A" and Short-term Issuer Rating at R-1 (low). At the same time, the trend on the Long-Term Issuer Rating has been changed to Positive from Stable. The trend on the Short-Term Issuer Rating remains Stable.

KEY CREDIT RATING CONSIDERATIONS

The Positive trend on the long-term issuer rating is underpinned by the trend change to Positive from Stable on the Kingdom of Spain's Long-Term Foreign and Local Currency - Issuer Rating of "A" on 31 May 2024, and also reflects Madrid's strong financial management and favourable fiscal track record.

Madrid's credit ratings are underpinned by (1) its large and diversified economy as Spain's capital city; (2) its strong financial performance over the past decade and sound medium-term fiscal outlook; and (3) its debt metrics, which are at relatively low levels, and effective public-sector debt management strategy. Madrid's credit ratings also benefit from Morningstar DBRS' assessment of a high likelihood of support from the Kingdom of Spain (rated "A", Positive trend by Morningstar DBRS). Morningstar DBRS takes the view that, despite Madrid's intrinsic strengths, it does not qualify to be rated higher than the sovereign because its current revenue framework is not constitutionally protected. Madrid's credit ratings are capped by the Kingdom of Spain's credit ratings.

CREDIT RATING DRIVERS

The credit ratings could be upgraded if the Kingdom of Spain's credit ratings are upgraded.

The trend on the long-term credit rating could return to Stable if the positive trend on the Kingdom of Spain reverts to Stable. The credit ratings could be downgraded if any or a combination of the following occur: (1) the Kingdom of Spain's credit ratings are downgraded; and (2) although currently unlikely given its intrinsic strengths, a structural weakening in the city's fiscal performance, leading fiscal deficits to widen over time and to a sustained and material rise in public-sector debt.

CREDIT RATING RATIONALE

City of Madrid's Fiscal Performance Remains Strong, and Return of Fiscal Rules Helps for Continuity

Madrid's financial performance improved significantly in 2023 with a financing surplus accounting for 6.1% of operating revenues following a deficit of 4.7% in 2022. This fiscal improvement stemmed from an improvement in operating performance and a decrease in capital expenditure (capex). The increase in operating surplus was supported by higher tax revenues and fees from municipal services. In terms of capital investments, the municipality decreased its capex because of slowing budget execution from the lower investment activity during the municipal elections.

Morningstar DBRS views the city's fiscal performance in 2023 and its fiscal outlook for 2024 as sound, despite expecting the municipality to continue its fiscal policy of reducing rates on its own taxes progressively. The central government is compensating

part of the revenue loss related to the negative settlement in 2020. Following the decision of the Spanish Constitutional Court, Madrid has repaid in 2022 most of its revenues related to the municipal capital gains taxes which were considered legally undue. This underpins the much stronger fiscal performance in 2023 and 2024. However, the city's 2024 budget also expects expenditures to grow, especially since the 2022 budget was rolled over into 2023. Inflation and staff costs are the main drivers of this growth, but projected investments are lower than in the previous budget because of the lower investments needs than in 2022. The budget is expected to result in a slight financing surplus. Morningstar DBRS considers the municipality to be usually prudent on its budgeting as it has strong ability and fiscal headroom to prevent a sustained deterioration in its fiscal and financial performance.

The Independent Authority for Fiscal Responsibility's (AIREF) report considers that the expected return of the country's budget stability law would strengthen the municipality's fiscal discipline, likely leading to further debt reductions. AIREF's report also recommends that the city control expenditure growth since the average during the last three years was considerably higher than previous years, mainly because the budget stability targets were not binding; however, the city has demonstrated strong fiscal discipline over the last years, and the 2024 budget is expected to result in a slight surplus. In addition, Madrid benefits from fiscal headroom and fiscal flexibility, which would allow the city to increase its tax receipts by more than EUR 500 million, or 9% of operating revenues, by raising local tax rates if needed.

Slight Increase of the Debt in 2023 But Strong Liquidity And Debt Profile Remains as an Outstanding City's Feature

As of end-2023, the municipality's debt stock remained below EUR 2.0 billion for the fourth consecutive year. After a long period of decreasing debt until 2021, the city's debt increased for the second consecutive year to nearly EUR 2.0 billion at end-2023 from EUR 1.7 billion in 2022. However, thanks to a substantial increase in operating revenues, the debt ratio fell to 40% of operating revenues from 41% in 2022. The municipality plans to progressively reduce its debt to EUR 1.7 billion in 2027 and for the debt ratio to remain far below the 75% limit set in the national government's budget stability law; surpassing this limit would prompt a need for pre-approval of any debt operation from the Ministry of Finance. Morningstar DBRS is not concerned by the current debt increase since Madrid has some fiscal space, and Morningstar DBRS expects the municipal debt ratio to keep decreasing further.

Madrid's debt structure is very sound: all debt is denominated in euros, the majority of debt is at fixed rates, and the debt has a relatively long average life at 6.3 years as of end-2023. The relatively longer life of debt benefits from Madrid's access to bond markets, which is one of the municipality's outstanding features. Madrid benefits from higher diversification of funding, which facilitates effective debt management. Despite the low risk of contingent liabilities, the city will take full ownership of the principal highway (M30) in 2025, which shareholding is currently shared with a private company acting as the operator. Morningstar DBRS expects the city to cover its 2024 funding needs with new debt, which will match the debt falling due, and to maintain its current diversification of funding.

Madrid's liquidity position is strong. Cash amounted to EUR 793 million at end-2023, with debt repayments for the next four years fully covered and access to credit line facilities available for EUR 450 million. The credit lines were not used during 2023, and the average supplier's payment period has mostly remained at the target of 30 days. Additionally, Madrid could call for the national government to backstop financing support under financial distress, although this is currently unlikely; hence, Morningstar DBRS is confident that the city can meet its financing requirements.

Madrid's Strong Economy Remains Underpinned by High Employment and Strong Tourism Performance

Madrid is the capital of and the most populated city in Spain, with a population of approximately 3.3 million and a GDP estimated at around EUR 169 billion at the end of 2022. The city is located in the Autonomous Community of Madrid (rated "A" with a Positive trend by Morningstar DBRS), which benefits from the largest regional economy in Spain, representing close to 20% of Spain's GDP. Morningstar DBRS expects the municipal economy to continue growing broadly in line with the regional economy. For 2022, Madrid's real GDP grew by 7.2%, better than Spain's growth rate of 5.8%, and AIREF expects Madrid's real GDP to grow by 3.0%

and 2.1% in 2023 and 2024, respectively. Morningstar DBRS expects the regional economy to continue growing as a consequence of the region's high employment level and strong tourism performance.

The post-pandemic recovery in tourism has been stronger nationally than in Madrid. Tourist arrivals in 2023 were already higher than those in 2019 and this is the case for overnight stays since the beginning of 2024.

Madrid recorded an all-time employment level record in April 2024 with around 3.7 million workers, after strong annual growth of 3.6%. The level of employment has remained elevated during the last two years and could partially explain why the region benefits from the highest GDP per capita in the country, estimated at EUR 38,435 in 2022, or 36% above the national average.

The financial resources expected from NextGenerationEU (NGEU), including the Recovery and Resilience Facility (RRF) and REACT-EU funds, should continue to support reforms and investments. The city estimates that total revenues to be received from these EU funds would amount to around EUR 461 million, and, as of September 2023, EUR 387 million had been spent since 2020.

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE CONSIDERATIONS

General Considerations

ESG Considerations had a relevant effect on the credit analysis.

Social (S) Factors

The Passed-through Social credit considerations have a relevant effect on the credit ratings, as the social factors affecting the Kingdom of Spain's credit ratings are passed-through to City of Madrid.

There were no Environmental or Governance factors that had a significant or relevant effect on the credit analysis.

A description of how Morningstar DBRS considers ESG factors within the Morningstar DBRS analytical framework can be found in the Morningstar DBRS Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings (23 January 2024) <https://dbrs.morningstar.com/research/427030/morningstar-dbrs-criteria:-approach-to-environmental,-social,-and-governance-risk-factors-in-credit-ratings>

RATING COMMITTEE SUMMARY

Morningstar DBRS' European Sub-Sovereign Scorecard generates a result in the AA (high) - AA (low) range. The main points discussed during the Rating Committee included the fiscal and financial impacts of the potential upgrade of Kingdom of Spain's rating, the debt evolution in 2023, the economic situation in the city and its outlook, financial and fiscal forecasts.

For more information on the Key Indicators used for the Kingdom of Spain, please see the Sovereign Scorecard Indicators and Building Block Assessments: <https://dbrs.morningstar.com/research/433832>.

The national scorecard indicators were used for the sovereign rating. The Kingdom of Spain's rating was an input to the credit analysis of the City of Madrid.

Notes:

All figures are in Euros unless otherwise noted.

The principal methodology is the Rating European Sub-Sovereign Governments (15 April 2024) <https://dbrs.morningstar.com/research/431201/rating-european-sub-sovereign-governments> In addition Morningstar DBRS uses the Morningstar DBRS

Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings (23 January 2024) <https://dbrs.morningstar.com/research/427030/morningstar-dbrs-criteria:-approach-to-environmental,-social,-and-governance-risk-factors-in-credit-ratings> in its consideration of ESG factors.

The credit rating methodologies used in the analysis of this transaction can be found at: <https://dbrs.morningstar.com/about/methodologies>.

The sources of information used for these credit ratings include Morningstar, Inc. and company documents. Other sources include City of Madrid for financial position for the 2015-23 period (annual accounts for the 2015-22 period), annual budgetary execution documents for 2023, economic structure for 2023, and debt structure documentation for the 2016-23 period, Bank of Spain for the debt stock during the period between 2015 and 2023 (Debt according to the excessive deficit procedure documents), Independent Authority for Fiscal Responsibility (AIREF) for its Complementary Report on Individual Budgets of the 2024 local governments (Informe complementario de evaluación individual de los presupuestos para 2024 de las corporaciones locales, April 2024), and for its economic and financial information observatory of Autonomous Communities, Instituto Nacional de Estadística (INE), Ministry of Finance; the Spring 2024 economic forecast from the European Commission, 2020 European Social Progress Index, Haver Analytics. Morningstar DBRS considers the information available to it for the purposes of providing these credit ratings to be of satisfactory quality.

Morningstar DBRS does not audit the information it receives in connection with the credit rating process, and it does not and cannot independently verify that information in every instance.

The conditions that lead to the assignment of a Negative or Positive trend are generally resolved within a 12-month period. Morningstar DBRS's outlooks and credit ratings are under regular surveillance.

For further information on Morningstar DBRS historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see: <https://registers.esma.europa.eu/cerep-publication>. For further information on Morningstar DBRS historical default rates published by the Financial Conduct Authority (FCA) in a central repository, see <https://data.fca.org.uk/#/ceres/craStats>.

The sensitivity analysis of the relevant key credit rating assumptions can be found at: <https://www.dbrsmorningstar.com/research/434519>.

These credit ratings are endorsed by DBRS Ratings Limited for use in the United Kingdom.

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Initial Rating Date: April 22, 2022
Last Rating Date: December 15, 2023

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For more information on this credit or on this industry, visit dbrs.morningstar.com.

Ratings

Madrid, City of

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
14-Jun-24	Long-Term Issuer Rating	Confirmed	A	Stb	EU U
14-Jun-24	Long-Term Issuer Rating	Trend Change	A	Pos	EU U
14-Jun-24	Short-Term Issuer Rating	Confirmed	R-1 (low)	Stb	EU U

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